STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
(An Internal Service Fund of the State of Alaska)

Financial Statements

June 30, 2009 and 2008

(With Independent Auditors' Report Thereon)

STATE OF ALASKA
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(An Internal Service Fund of the State of Alaska)

June 30, 2009 and 2008

Table of Contents

KPMG

KPMG LLP
Suite 600
701 West Eighth Avenue
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Independent Auditors' Report

Division of Retirement and Benefits and
Members of the Alaska Retirement Management Board
State of Alaska Group Health and Life Fund:

We have audited the accompanying statements of net assets of the State of Alaska Group Health and Life Fund (Plan), an Internal Service Fund of the State of Alaska, as of June 30, 2009 and 2008, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the State of Alaska Group Health and Life Fund as of June 30, 2009 and 2008, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

KPMG LLP

November 13, 2009

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
(An Internal Service Fund of the State of Alaska)

Management's Discussion and Analysis

June 30, 2009 and 2008

This section presents management's discussion and analysis (MD&A) of the Group Health and Life Fund's (Plan) financial condition and performance for the years ended June 30, 2009 and 2008. This section is presented as a narrative overview and analysis. Please read the MD&A in conjunction with the financial statements and notes to financial statements to better understand the financial condition and performance of the Plan during the fiscal years ended June 30, 2009 and 2008. Information for fiscal year 2007 is presented for comparative purposes.

Financial Highlights

The Plan's unrestricted net assets as of June 30, 2009 and 2008 are $30,991,715 and $38,909,709, respectively.

The Plan's unrestricted net assets as of June 30, 2009 and 2008 decreased by $7,917,994 or -20.3% and increased by $4,378,088 or 12.7% from fiscal years 2008 and 2007, respectively.

Total health premiums totaled $75,267,871 and $71,743,010 during fiscal years 2009 and 2008; reflecting an increase of $3,524,861 and $1,719,638 or 4.9% and 2.5% from fiscal years 2008 and 2007, respectively.

Investment earnings decreased from $2,944,845 in 2008 to $2,014,629 in 2009 and increased from $2,383,959 in 2007 to $2,944,845 in 2008; reflecting a decrease of -31.6% and an increase of 23.5% in 2008 and 2007, respectively.

Benefit expense totaled $80,599,402 and $66,882,688 during fiscal years 2009 and 2008; reflecting an increase of $13,716,714 and $5,023,432 or 20.5% and 8.1% from fiscal years 2008 and 2007, respectively.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Plan's basic financial statements. The Plan's basic financial statements are comprised of four components: (1) statement of net assets, (2) statement of revenues, expenses and changes in net assets, (3) statement of cash flows, and (4) notes to financial statements.

Statement of Net Assets – This statement presents information regarding the Plan's assets, liabilities, and resulting unrestricted net assets. Net assets represent the total amount of assets less the total amount of liabilities.

Statement of Revenues, Expenses, and Changes in Net Assets – This statement presents how the Plan's net assets changed during the fiscal years ended June 30, 2009 and 2008 as a result of health premiums, investment income, and operating expenses.

Statement of Cash Flows – This statement presents cash flows from operations and investing activities. The Plan presents its cash flows statement using the direct method for reporting cash received and disbursed during the fiscal year.

The above statements represent resources available for investment and payment of benefits as of June 30, 2009 and 2008, and the sources and uses of those funds during fiscal years 2009 and 2008.

Notes to Financial Statements –The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules that is essential to a full understanding of the Plan's financial statements.

Condensed Financial Information

	Net assets				
			Increase/(decrease)		
Description	**2009**	**2008**	**Amount**	**Percentage**	**2007**
Assets:					
Cash and cash equivalents	$ 44,741,173	50,671,346	(5,930,173)	(11.7)%	47,396,359
Securities lending collateral	—	—	—	n/a	9,438,417
Receivables	15,027	75,888	(60,861)	(80.2)	480,925
Other assets	840,649	—	840,649	100.0	—
Total assets	45,596,849	50,747,234	(5,150,385)	(10.1)	57,315,701
Liabilities:					
Claims payable	12,491,742	10,627,127	1,864,615	17.5	12,407,841
Due to State of Alaska General Fund	1,341,286	609,813	731,473	120.0	276,043
Accrued expenses	772,106	600,585	171,521	28.6	661,779
Securities lending collateral payable	—	—	—	n/a	9,438,417
Total liabilities	14,605,134	11,837,525	2,767,609	23.4	22,784,080
Net assets	$ 30,991,715	38,909,709	(7,917,994)	(20.3)%	34,531,621

	Changes in net assets				
			Increase/(decrease)		
Description	**2009**	**2008**	**Amount**	**Percentage**	**2007**
Net assets, beginning of year	$ 38,909,709	34,531,621	4,378,088	12.7%	26,087,071
Operating revenues:					
Health premiums	75,267,871	71,743,010	3,524,861	4.9	70,023,372
Other revenues	744,868	716,385	28,483	4.0	1,169,559
Total operating revenues	76,012,739	72,459,395	3,553,344	4.9	71,192,931
Operating deductions:					
Benefits	80,599,402	66,882,688	13,716,714	20.5	61,859,256
Administrative	5,345,960	4,143,464	1,202,496	29.0	3,273,084
Total operating deductions	85,945,362	71,026,152	14,919,210	21.0	65,132,340
Operating income (loss)	(9,932,623)	1,433,243	(11,365,866)	(793.0)	6,060,591
Nonoperating revenues:					
Net investment income	2,014,629	2,944,845	(930,216)	(31.6)	2,383,959
Changes in net assets	(7,917,994)	4,378,088	(12,296,082)	(280.9)	8,444,550
Net assets, end of year	$ 30,991,715	38,909,709	(7,917,994)	(20.3)%	34,531,621

Financial Analysis of the Plan

The Statement of Net Assets as of June 30, 2009 and 2008 showed total assets exceeding total liabilities by $30,991,715 and $38,909,709, respectively. These amounts represent the total plan net assets held in trust for healthcare benefits on each of those dates. The entire amount is available to cover the Plan's obligations to pay healthcare benefits for its members and their beneficiaries.

These amounts also represent a decrease in net assets of ($7,917,994) or -20.3% and an increase in net assets of $4,378,088 or 12.7% over fiscal years 2008 and 2007, respectively. Over the long term, healthcare premiums collected and investment income earned are expected to cover all claims costs. With continued increases in healthcare costs, the Plan must continue to accumulate assets to meet current and future claims costs.

Premium Calculations

The overall objective of the Plan is to have sufficient funds to meet claim costs. The premiums are recommended each year by the Division of Retirement and Benefits' (Division) benefit consultant with the governing body's concurrence and the Administrator's approval. Premiums are based on the Plan's fiscal year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to recommend premiums for the next fiscal year.

Healthcare Premiums and Investment Income

The revenues required to fund healthcare benefits are accumulated through a combination of employer health premiums, member health premiums, other income, and net investment income.

	Revenues				
			Increase/(decrease)		
	2009	2008	Amount	Percentage	2007
Health insurance premiums	$ 75,267,871	71,743,010	3,524,861	4.9%	70,023,372
Other income	744,868	716,385	28,483	4.0	1,169,559
Net investment income	2,014,629	2,944,845	(930,216)	(31.6)	2,383,959
Total	$ 78,027,368	75,404,240	2,623,128	3.5%	73,576,890

Over the long term, health premiums earned and net investment income is expected to cover all costs of the Plan.

Healthcare premiums increased from $851 per month per person in fiscal year 2008 to $867 per month per person in fiscal year 2009. Premiums were $835 in fiscal year 2007. Increases to health premiums are the result of rising healthcare costs related to covered benefits. Premiums are based on historical and anticipated experience. During fiscal year 2009, there was also a net increase of approximately 200 members over fiscal year 2008.

Net investment income decreased by $930,216 or -31.6% from amounts recorded in fiscal year 2008 and increased by $560,886 or 23.5% from amounts recorded in fiscal year 2007. In fiscal year 2009, the decrease was due to lower returns on investments as well as a lower invested balance from higher healthcare costs. In fiscal year 2008, the increase was due to higher returns on investments as well as a higher invested balance. Investments earned 4.24% in fiscal year 2009, 5.85% in fiscal year 2008 and 5.60% in fiscal year 2007. The invested balance decreased ($5,930,173) in fiscal year 2009, and increased $3,274,987 and $11,151,442 in fiscal years 2008 and 2007, respectively.

Benefits and Expenses

The primary expense of the Plan is the payment of healthcare benefits. These benefit costs and the cost of administering the Plan comprises the costs of operation.

	Expenses				
			Increase/(decrease)		
	2009	2008	Amount	Percentage	2007
Healthcare benefits	$ 80,599,402	66,882,688	13,716,714	20.5%	61,859,256
Administrative	5,345,960	4,143,464	1,202,496	29.0	3,273,084
Total	$ 85,945,362	71,026,152	14,919,210	21.0%	65,132,340

Benefit expense increased $13,716,714 and $5,023,432 or 20.5% and 8.1% from fiscal years 2008 and 2007. The increases in fiscal years 2009 and 2008 were due to increasing healthcare costs and an increase in covered members.

Administrative expenses increased $1,202,496 and $870,380 or 29.0% and 26.6% from fiscal years 2008 and 2007. The increase was due to the administrative fee per member per month increasing from $32.16 in fiscal year 2008 to $33.77 in fiscal year 2009. Additionally, there was $450,000 in network savings paid to the third party administrator based on meeting contract requirements. The Plan also participated in two new items during fiscal year 2009: (1) creation of the Health Risk Assessment through WebMD, which cost the Plan approximately $348,000 and (2) an incentive program that paid participating members $100 for completing the Health Risk Assessment, which cost approximately $202,000.

Increases to healthcare benefit expenses are expected in the future. The Plan's benefit consultants have identified and developed premiums necessary to cover the anticipated increased claims costs.

Economic Conditions, Market Environment, and Results

The overall objective of the Plan is to have sufficient resources available to pay current and future claim costs. The premiums are calculated each fiscal year based on the anticipated claims and administrative costs for the following year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to develop premiums for the next fiscal year.

Requests for Information

This financial report is designed to provide a general overview of the Plan's financial condition for those with interest in the Plan's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

State of Alaska Group Health and Life Fund
Division of Retirement and Benefits, Accounting Section
P.O. Box 110203
Juneau, Alaska 99811–0203

STATE OF ALASKA
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Statements of Net Assets

June 30, 2009 and 2008

		2009	2008
Assets:			
Cash and cash equivalents (notes 3, 4 and 5):			
Investment in State of Alaska General Fund and other Nonsegregated Investments Pool	$	44,741,173	50,671,346
Premiums receivable		15,027	75,888
Other assets (note 7)		840,649	—
Total assets		45,596,849	50,747,234
Liabilities:			
Claims payable (note 6)		12,491,742	10,627,127
Due to State of Alaska General Fund (note 6)		1,341,286	609,813
Accrued expenses		772,106	600,585
Total liabilities		14,605,134	11,837,525
Unrestricted net assets	$	30,991,715	38,909,709

See accompanying notes to financial statements.

STATE OF ALASKA
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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2009 and 2008

	2009	2008
Operating revenues:		
Employer health premiums	$ 61,490,471	58,319,516
Member health premiums	13,777,400	13,423,494
Other	744,868	716,385
Total operating revenues	76,012,739	72,459,395
Operating expenses:		
Benefits	80,599,402	66,882,688
Administrative	5,345,960	4,143,464
Total operating expenses	85,945,362	71,026,152
Operating income (loss)	(9,932,623)	1,433,243
Nonoperating revenues:		
Investment income	2,014,629	2,921,260
Net investment income before securities lending activities	2,014,629	2,921,260
Securities lending income (note 5)	—	210,499
Less securities lending expense (note 5)	—	186,914
Net income from securities lending activities	—	23,585
Net investment income	2,014,629	2,944,845
Change in net assets	(7,917,994)	4,378,088
Total net assets, beginning of year	38,909,709	34,531,621
Total net assets, end of year	$ 30,991,715	38,909,709

See accompanying notes to financial statements.

STATE OF ALASKA
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Statements of Cash Flows

Years ended June 30, 2009 and 2008

		2009	2008
Operating activities:			
Cash received for premiums within the states' entity	$	74,811,585	71,252,448
Cash received from others for premiums		517,147	464,889
Cash received from third party administrator		744,868	1,147,094
Cash payments to third party administrator for benefits		(78,003,314)	(68,329,632)
Cash payments to employees		(194,196)	(199,328)
Cash payments to suppliers		(5,820,892)	(4,005,328)
Net cash (used) provided by operating activities		(7,944,802)	330,143
Investing activities:			
Net investment income received		2,014,629	2,944,844
Net cash provided by investing activities		2,014,629	2,944,844
Net (decrease) increase in cash and cash equivalents		(5,930,173)	3,274,987
Cash and cash equivalents, beginning of year		50,671,346	47,396,359
Cash and cash equivalents, end of year	$	44,741,173	50,671,346
Operating activities:			
Operating income (loss)	$	(9,932,623)	1,433,243
Adjustments to reconcile operating income to net cash provided by operating activities:			
(Increase) decrease in assets:			
Premiums receivable		60,861	405,037
Other assets		(840,649)	—
Increase (decrease) in liabilities:			
Claims payable		1,878,000	(1,987,000)
Due to State of Alaska General Fund		731,473	333,770
Accrued expenses		158,136	145,093
Net cash (used) provided by operating activities	$	(7,944,802)	330,143

See accompanying notes to financial statements.

(1) Description

The following brief description of the State of Alaska Group Health and Life Fund (Plan), an Internal Service Fund of the State of Alaska (State), is provided for general information purposes only. Members should refer to the Select Benefits Information Booklet for more complete information.

General

The Plan was established on July 1, 1997, to provide self–insured healthcare benefits to eligible employees of the State of Alaska. The Plan is an internal service fund of the State financial reporting entity and is included as such in the State's comprehensive annual financial report. As of June 30, 2009 and 2008, there were approximately 6,000 and 5,800 employees, excluding dependents, covered by the Plan, respectively.

Prior to July 1, 1997, healthcare benefits for State employees were fully insured through the payment of premiums to an insurance company.

Benefits

The Plan offers medical, dental, vision and audio benefits to eligible State employees and their dependents.

Eligibility

This Plan does not provide benefits to members of the following collective bargaining units, who chose to receive health coverage through a union trust:

- Labor, Trades and Crafts Unit
- Public Safety–Airport Security Unit
- Public Safety–Troopers Unit
- Correspondence Teachers Unit
- Masters Mates and Pilots
- Mt. Edgecumbe Teachers Unit
- General Government Unit

All other permanent and long-term nonpermanent employees of the State are covered by the Plan, including permanent and long-term nonpermanent seasonal and part–time employees who elect coverage.

The Plan also provides coverage for State legislators and elected officials.

Flexible Benefits

Employees who are not covered through a union trust are eligible for flexible healthcare benefits. Under this program, employees are provided benefit credits by the State. Employees can use the benefit credits to purchase the benefits they want. Benefit credits equal the amount that the State contributes towards health benefits for all employees. The amount of benefit credits each employee receives is decided by the

(1) Description (cont.)

legislature and/or the appropriate collective bargaining agreement and can be adjusted each year. Each of the available options offers different benefits or pays benefits at different rates. If the cost of the benefit option selected by an employee exceeds the amount of their benefit credits, the difference is funded by the employee through pre–tax payroll deductions. If the cost of the benefit options selected by an employee is less than the amount of their benefit credits, the remaining benefit credits are contributed to a healthcare reimbursement account for that employee.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The Plan's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Premiums are recognized in the period in which they are due. Benefits are recognized when due and payable.

Financial Statement Presentation

The Plan distinguishes operating revenues and expenses from nonoperating revenues and expenses. Operating revenues and expenses generally result from providing services in connection with the Plan's principal ongoing operations. The principal operating revenues of the Plan are employer and member contributions. Operating expenses for the Plan include benefits and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

Investments

Investments are recorded at fair value. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller – that is, other than in a forced or liquidation sale." Security transactions are accounted for on a trade date (ownership) basis at the current fair value.

The Plan participates in the State General Fund and Other Nonsegregated Investments (GeFONSI) pool. GeFONSI invests in fixed income securities that are valued each business day using an independent pricing service. Money market funds are valued at amortized cost, which approximates fair value.

GeFONSI investment income is distributed to pool participants if prescribed by statute or if appropriated by state legislature.

(2) Summary of Significant Accounting Policies (cont.)

Statements of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include the Plan's investment in the GeFONSI, which includes appreciation (depreciation) at June 30, 2009 and 2008. This investment pool has the general characteristics of a demand deposit account.

Administration

The Plan is administered by the State's Division of Retirement and Benefits (Division). The Division utilizes the services of a claims administrator, Premera, to process all medical, dental, and prescription drug claims. Some of the managed–care vision benefits provided by the Plan are administered by Vision Service Plan (VSP).

Funding

The Plan is self–insured for all benefits. The Plan's funding policy provides for the collection of premiums from employees, if applicable, and the State. Premium amounts are actuarially determined on an annual basis and adjusted as necessary. The State retains the risk of loss of allowable claims.

Due From (To) State of Alaska General Fund

Amounts due from (to) the State of Alaska General Fund represent the net difference between amounts paid by the Plan on behalf of others and amounts paid by others on behalf of the Plan.

Federal Income Tax Status

The Plan is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code.

(3) Investments

The Plan invests in the State's internally managed General Fund and Other Nonsegregated Investments pool (GeFONSI). GeFONSI consists of investments in the State's internally managed Short–term and Intermediate–term Fixed Income Pools. Actual investing is performed by investment officers in the State's Department of Revenue, Treasury Division. A complete description of the investment policy for each pool is included in the *Department of Revenue, Treasury Division, Policies and Procedures Manual*.

Assets in the pools are reported at fair value. Investment purchases and sales are recorded on a trade-date basis.

Fixed income securities are valued each business day using prices obtained from a pricing service when such prices are available; otherwise, such securities are valued at the most current sale price or based on a valuation provided by investment managers.

The accrual basis of accounting was used for investment income and GeFONSI investment income was distributed to pool participants monthly if prescribed by statute or if appropriated by the state legislature.

(3) Investments (cont.)

At June 30, 2009, the Plan's share of pool investments was as follows:

	Fair value			
	Short-term Fixed Income Pool	**Intermediate-term Fixed Income Pool**	**Other**	**Total**
Deposit	$ 54,006	—	—	54,006
Commercial paper	1,083,009	—	—	1,083,009
U.S. Treasury notes	—	12,136,490	—	12,136,490
U.S. Treasury bills	6,110,302	—	—	6,110,302
U.S. government agency	473,845	7,908,896	—	8,382,741
Mortgage-backed	681,594	2,506,987	—	3,188,581
Other asset-backed	2,157,815	164,845	—	2,322,660
Corporate bonds	5,833,431	2,919,890	—	8,753,321
Yankees:				
Government	—	208,463	—	208,463
Corporate	1,255,740	1,150,228	—	2,405,968
Total invested assets	17,649,742	26,995,799	—	44,645,541
Pool related net assets	23,995	73,448		97,443
Net invested assets	17,673,737	27,069,247	—	44,742,984
Participant unallocated cash	—	—	(1,811)	(1,811)
Net cash and cash equivalents	$ 17,673,737	27,069,247	(1,811)	44,741,173

(3) Investments (cont.)

At June 30, 2008, the Plan share of pool investments was as follows:

	Fair value			
	Short-term Fixed Income Pool	**Intermediate-term Fixed Income Pool**	**Other**	**Total**
Overnight sweep account	$ 45,805	—	—	45,805
Commercial paper	1,465,609	—	—	1,465,609
U.S. Treasury notes	—	15,842,670	—	15,842,670
U.S. government agency	9,781,943	3,831,936	—	13,613,879
Mortgage-backed	785,906	3,947,107	—	4,733,013
Other asset-backed	4,556,821	1,042,992	—	5,599,813
Corporate bonds	4,313,216	2,348,372	—	6,661,588
Yankees:				
Government	—	283,923	—	283,923
Corporate	1,293,217	819,983	—	2,113,200
Total invested assets	22,242,517	28,116,983	—	50,359,500
Pool related net assets	143,559	170,872	—	314,431
Net invested assets	22,386,076	28,287,855	—	50,673,931
Participant unallocated cash	—	—	(2,585)	(2,585)
Net cash and cash equivalents	$ 22,386,076	28,287,855	(2,585)	50,671,346

(4) Deposit and Investment Risk

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100–basis point change in interest rates. The duration of a pool is the average fair value weighted duration of each security in the pool taking into account all related cash flows.

Treasury uses industry–standard analytical software developed by The Yield Book Inc. to calculate effective duration. The software takes into account various possible future interest rates, historical and estimated prepayment rates, call options and other variable cash flows for purposes of the effective duration calculation.

(4) Deposit and Investment Risk (cont.)

Short–term Fixed Income Pool

As a means of limiting its exposure to fair value losses arising from increasing interest rates, Treasury's investment policy limits individual fixed rate securities to fourteen months to maturity or fourteen months expected average life upon purchase. Floating rate securities are limited to three years to maturity or three years expected average life upon purchase. Treasury utilizes the actual maturity date for commercial paper and twelve-month prepay speeds for other securities. At June 30, 2009, the expected average life of individual fixed rate securities range from one day to six and one-half years and the expected average life of floating rate securities ranged from one day to eight years.

Intermediate–term Fixed Income Pool

Through its investment policy, Treasury manages its exposure to fair value losses arising from increasing interest rates by limiting the effective duration of the Intermediate-Term Fixed Income Pool portfolio to ± 20% of the Merrill Lynch 1–5 year Government Bond Index. The effective duration for the Merrill Lynch 1–5 year Government Bond Index at June 30, 2009, was 2.54 years.

At June 30, 2009, the effective duration by investment type was as follows:

	Effective duration (In years)
	Intermediate-term Fixed Income Pool
Corporate bonds	2.10
Mortgage-backed	2.42
Other asset-backed	0.71
U.S. Treasury notes	3.07
U.S. Government and agency securities	2.02
Yankees:	
Corporate	2.81
Government	2.73
Portfolio effective duration	**2.52**

Credit Risk

Credit risk is the risk that an issuer or other counter party to an investment will not fulfill its obligations.

(4) Deposit and Investment Risk (cont.)

Treasury's investment policy has the following limitations with regard to credit risk:

Short–term Fixed Income Pool investments are limited to instruments with a long–term credit rating of at least A3 or equivalent and instruments with a short–term credit rating of at least P-1 or equivalent. Asset-backed and non-agency mortgage securities must be rated A3 or equivalent. The A3 rating is defined as the median rating of the following three rating agencies: Standard & Poor's Corporation, Moody's and Fitch. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA.

Intermediate–term Fixed Income Pool investments are limited to securities with a long–term credit rating of at least Baa3 or equivalent and securities with a short–term credit rating of at least P-1 or equivalent. Asset-backed and non-agency mortgage securities must be rated investment grade. The investment grade rating is defined as the median rating of the following three rating agencies: Standard & Poor's Corporation, Moody's and Fitch. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA.

(4) Deposit and Investment Risk (cont.)

At June 30, 2009, the State's internally managed pools consisted of investments with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard and Poor's Corporation rating scale):

Investment type	Rating	Short-term Fixed Income Pool	Intermediate-term Fixed Income Pool
Commercial Paper	A-1	1.10%	—%
Commercial Paper	Not Rated	5.05	—
U.S. Treasury notes	AAA	—	44.01
U.S. Treasury bills	AAA	34.70	—
U.S. Government Agency	AAA	2.69	27.68
U.S. Government Agency	Not Rated	—	1.00
Mortgage-backed	AAA	3.46	7.42
Mortgage-backed	A	0.11	—
Mortgage-backed	BBB	0.18	—
Mortgage-backed	Not Rated	0.30	1.67
Other asset-backed	AAA	10.87	0.39
Other asset-backed	AA	0.85	0.05
Other asset-backed	A	0.35	0.15
Other asset-backed	BBB	—	—
Corporate Bonds	AAA	19.33	4.49
Corporate Bonds	AA	6.16	1.36
Corporate Bonds	A	7.64	2.92
Corporate Bonds	BBB	—	1.81
Yankees:			
Government	AA	—	0.76
Corporate	AAA	1.61	2.56
Corporate	AA	4.29	0.91
Corporate	A	1.24	0.48
Corporate	BBB	—	0.17
Corporate	Not Rated	—	0.05
No Credit Exposure		0.07	2.12
		100.00%	100.00%

Concentration of Credit Risk

Treasury's policy with regard to concentration of credit risk is to prohibit the purchase of more than five percent of a pool's holdings in corporate bonds of any one company or affiliated group. Federal National Mortgage Association, Federal Home Loan Corporation, and Federal Home Loan Bank securities are not classified as corporate bonds.

(4) Deposit and Investment Risk (cont.)

At June 30, 2009, the Plan had more than five percent of their investments in Federal National Mortgage Association, Federal Home Loan Corporation, and Federal Home Loan Bank as follows:

		Fair value	Percent of total investments
Federal National Mortgage Association	$	2,880,763	6.44%
Federal Home Loan Corporation		2,859,729	6.39
Federal Home Loan Bank		3,193,034	7.14

(5) Securities Lending

Alaska Statute 37.10.071 authorized the Commissioner to lend assets, under an agreement and for a fee, against deposited collateral. In February 2008, the Commissioner suspended the securities lending agreement with the Bank which lent equity and domestic fixed income securities. Prior to suspension, the Bank, acting as the Commissioner's agent under the agreement, transferred securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agreed to return the collateral for the same securities in the future. At June 30, 2009 and 2008, there were no outstanding securities on loan.

At June 30, 2009 and 2008, there were no loans allocable to the Plan. While the securities lending agreement was active, there was no limit to the amount that could be loaned and the Commissioner was able to sell securities on loan. International equity security loans were collateralized at not less than 105% of their fair value. All other security loans were collateralized at not less than 102% of their fair value. Loaned securities and collateral were marked to market daily and collateral was received or delivered the following day to maintain collateral levels.

Cash collateral was invested in a registered 2(a)–7 money market fund. Maturities of investments in the money market fund generally did not match the maturities of the loaned securities because the lending agreements were terminable at will. Collateral securities could have been pledged or sold upon borrower default. Since the Commissioner did not have the ability to pledge or sell the securities collateral unless the borrower defaulted, they were not recorded on the financial statements. Securities under loan, cash collateral and cash collateral payable were recorded on the financial statements at fair value. The Bank, the Plan and the borrower received a fee from earnings on invested collateral. The Bank and the Plan shared a fee paid by the borrower for loans not collateralized with cash.

There was limited credit risk associated with the lending transactions since the Commissioner was indemnified by the Bank against any loss resulting from counterparty failure or default on the loaned security or is related income distributions. The Bank further indemnified the Board against loss due to borrower rebates in excess of earning on cash collateral. Indemnifications were subject to limitation related to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

(5) Securities Lending (cont.)

For the years ended June 30, 2009 and 2008, there were no losses incurred as a result of securities lending transactions and there were no violations of legal or contractual provisions or failures by any borrowers to return loaned securities.

(6) Claims Payable

The liability for claims incurred but not reported represents the estimated amounts necessary to settle all outstanding claims, incurred but not reported (IBNR), as of the balance sheet date. The Plan's reserve estimates are based primarily on historical development patterns adjusted for current trends that would modify past experience. Claims are reevaluated periodically to consider the effects of inflation, claims settlement trends and other economic factors. The process of establishing loss reserves is subject to uncertainties that are normal, recurring and inherent in the healthcare business.

Changes in the balances of claims liabilities during the years ended June 30 were as follows:

		2009	2008
Beginning of year:			
Due to State of Alaska General Fund for outstanding warrants	$	609,813	276,043
Outstanding claims included in accrued expenses		414,127	207,841
Incurred but not reported		10,213,000	12,200,000
Total, beginning of year		11,236,940	12,683,884
Benefit deduction		80,599,402	66,882,688
Benefits paid		(78,003,314)	(68,329,632)
Total, end of year	$	13,833,028	11,236,940
End of year:			
Due to State of Alaska General Fund for outstanding warrants	$	1,341,286	609,813
Outstanding claims included in claims payable		400,742	414,127
Incurred but not reported		12,091,000	10,213,000
Total, end of year	$	13,833,028	11,236,940

(7) Subsequent Event

During fiscal year 2009, the Division issued a request for proposal for claims administration. The contract for the third party administrator for claims payments was awarded to Wells Fargo Insurance Services (Wells Fargo). Wells Fargo began claims administration on July 1, 2009. To initiate claims payment on July 1, 2009, the Plan, along with the Retiree Health Fund, Public Employees', Teachers', and Judicial Alaska Retiree Health Care Trusts, each transferred an amount as an initial deposit with Wells Fargo. The Plan's portion of the deposit was $840,649 and is classified as other assets on the statement of net assets.